

## Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B01

PLR-105474-19

Date:

September 10, 2019

### LEGEND:

X =

State =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

a =

b =

Dear \_\_\_\_\_ :

This letter responds to a letter dated March 13, 2019, and subsequent correspondence, submitted on behalf of X by X's authorized representatives, requesting inadvertent termination relief under § 1362(f) of the Internal Revenue Code.

### Facts

The information submitted states that X is a corporation organized under the laws of State on Date 1. On Date 3, X made an election to be an S corporation effective Date 2.

At the close of three consecutive taxable years ending Date 6, X had subchapter C accumulated earnings and profits of \$a. In addition, for each taxable year ending Date 4, Date 5, and Date 6, X had passive investment income (within the meaning of § 1362(d)(3)) in excess of 25 percent of its gross receipts. As a result, X's S corporation election terminated on Date 7.

X represents that its tax advisors inadvertently failed to inform X of the passive investment rules. In addition, X represents that the termination of X's S corporation election was inadvertent and not motivated by tax avoidance or retroactive planning. X further represents that since Date 2, X and its shareholders have filed all returns consistent with X's status as an S corporation. X and its shareholders have agreed to make such adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary.

### Law and Analysis

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1362(d)(3)(A)(i) provides that an election under § 1362(a) shall be terminated whenever the corporation has accumulated earnings and profits at the close of each of three consecutive taxable years, and has gross receipts for each of such taxable years more than 25 percent of which are passive investment income.

Section 1362(d)(3)(A)(ii) provides that the termination under § 1362(d)(3) shall be effective on and after the first day of the first taxable year beginning after the third consecutive taxable year referred to in § 1362(d)(3)(A)(i).

Section 1362(d)(3)(C)(i) provides that the term "passive investment income" means, except as otherwise provided in § 1362(d)(3), gross receipts derived from royalties, rents, dividends, interest, and annuities.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation (A) was not effective for the taxable year for which made (determined without regard to § 1362(b)(2)) by reason of a failure to meet the requirements of § 1361(b) or to obtain shareholder consents or (B) was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in such ineffectiveness or termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness or termination, steps were taken (A) so that the corporation for which the election was made or the termination occurred is a small business corporation or (B) to acquire the shareholder consents, and (4) the corporation for which the election was made or the termination occurred, and each person who was a shareholder in such corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness or termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Section 1.1362-4(a) provides that a corporation is treated as continuing to be an S corporation during the period specified by the Commissioner if (1) the corporation made a valid election under § 1362(a) and the election terminated, (2) the Commissioner determines that the termination was inadvertent, (3) within a reasonable period of time after the discovery of the terminating event, steps were taken so that the corporation for which the termination occurred is a small business corporation, and (4) the corporation and shareholders agree to adjustments that the Commissioner may require for the period.

Section 1.1362-4(b) provides that for purposes of § 1.1362-4(a), the determination of whether a termination was inadvertent is made by the Commissioner. The corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination was inadvertent. The fact that the terminating event was not reasonably within the control of the corporation and was not part of a plan to terminate the election, or the fact that the terminating event or circumstance took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard itself against such an event or circumstance, tends to establish that the termination was inadvertent.

Section 1.1362-4(d) provides that the Commissioner may require any adjustments that are appropriate. In general, the adjustments required should be consistent with the treatment of the corporation as an S corporation during the period specified by the Commissioner.

Section 1375(a) provides that if for the taxable year an S corporation has (1) accumulated earnings and profits at the close of such taxable year, and (2) gross receipts more than 25 percent of which are passive investment income, then there is

imposed a tax on the income of such corporation for such taxable year. Such tax shall be computed by multiplying the excess net passive income by the highest rate of tax specified in § 11(b).

Section 1375(b)(1)(A) provides that for purposes of § 1375, except as provided in § 1375(b)(1)(B), the term “excess net passive income” means an amount which bears the same ratio to the net passive income for the taxable year as (i) the amount by which the passive investment income for the taxable year exceeds 25 percent of the gross receipts for the taxable year bears to (ii) the passive investment income for the taxable year.

Section 1375(b)(1)(B) provides that the amount of the excess net passive income for any taxable year shall not exceed the amount of the corporation’s taxable income for such taxable year as determined under § 63(a): (i) without regard to the deductions allowed by part VIII of subchapter B (other than the deduction allowed by § 248, relating to organizational expenditures), and (ii) without regard to the deduction under § 172.

Section 1.1368-1(f)(3) provides that an S corporation may elect to distribute all or part of its subchapter C earnings and profits through a deemed dividend. If an S corporation makes the election provided in § 1.1368-1(f)(3), the S corporation will be considered to have made the election provided in § 1.1368-1(f)(2) (relating to the election to distribute earnings and profits first).

Section 1.1368-1(f)(5)(iii) provides that a corporation makes an election for a taxable year under § 1.1368-1(f) by attaching a statement to a timely filed (including extensions) original or amended return required to be filed under § 6037 for that taxable year. In the statement, the corporation must identify the election it is making under § 1.1368-1(f) and must state that each shareholder consents to the election. The statement described in § 1.1368-1(f)(5)(iii) shall be verified by signing the return. A statement of election to make a deemed dividend under § 1.1368-1(f) must include the amount of the deemed dividend that is distributed to each shareholder.

### Conclusion

Based solely on the facts submitted and the representations made, we conclude that X’s S corporation election terminated on Date 7 under § 1362(d)(3)(A) because X had subchapter C earnings and profits at the close of each of three consecutive taxable years ending on Date 6, and had gross receipts for each of those taxable years more than 25 percent of which were passive investment income. We further conclude that the termination of X’s S corporation election was an inadvertent termination within the meaning of § 1362(f).

Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation beginning on Date 7, and thereafter, provided that Company’s S corporation

election was valid and has not otherwise terminated under § 1362(d), and provided that the following condition is met: a payment of \$b and a copy of this letter must be sent to the following address: Internal Revenue Service, Kansas City Submission Processing Campus, 333 W. Pershing Road, Kansas City, MO 64108, Stop 7777, Attn: Manual Deposit.

X must send this payment no later than 120 days from the date of this letter. If this condition is not met, then this ruling is null and void. Furthermore, if this condition is not met, X must notify the Kansas City Submission Processing Campus that its S corporation election has terminated.

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, we express or imply no opinion regarding X's eligibility to be an S corporation.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the ruling request, it is subject to verification on examination.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with a power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

Sincerely,

Joy C. Spies

Joy C. Spies  
Senior Technician Reviewer, Branch 1  
(Passthroughs & Special Industries)

Enclosures (2):  
Copy of this letter  
Copy for 6110 purposes

cc: